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SUBJECT: EXPERT ON BURMESE ECONOMY SPEAKS ON MICROFINANCE

REF: A) RANGOON 142 B) 08 RANGOON 698

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Summary and Comment  
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¶1. Dr. Sean Turnell, a leading expert on Burmese economics, spoke at Payap University, Chiang Mai on July 2, providing attendees a basic foundation for understanding Burma's current economic situation. Dr. Turnell briefly explained Burma's chaotic past, the evolution of its financial system, and the problems hindering the emergence of a viable financial sector. Dr. Turnell stated that hope is not lost for Burmese finance, as the microfinance industry is growing and providing small amounts of capital to needy borrowers.

¶2. Comment: Microfinance in Burma is bittersweet. On the one hand, microfinance gives access to credit where needy Burmese can obtain funding to pursue a number of ventures. On the other hand, microfinance in itself is not going to bring about the needed changes to manipulate the overall micro or macroeconomic situation in Burma. The junta's economic policies are the major hindrance to economic development in Burma. The Burmese military regime needs to restructure the financial system, ensure bank credibility, and engage the rest of the world in trade before substantial economic development occurs, stated Turnell. End Summary and Comment.

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A Turbulent History with Tumultuous Economics  
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¶3. Dr. Turnell began his presentation with an explanation of the chaotic history of Burmese economics and microfinance since the 1850s, when Burma was an English colony and the largest rice exporter in the world - a position it held until World War II. At this time, a majority of financial services were provided by Chettiars who lent money to farmers who used their land as collateral. As commodity prices crashed during the Great Depression, Burmese farmers defaulted or walked off their land, leaving the Chettiars with 50 percent of cultivable land.

14. In 1942, the Japanese invaded Burma causing the Chettiars to flee the country. The Japanese seized vast tracts of land and established their own currency and monetary institutions in Burma, but upon Japan's defeat in World War II, domestic legal tender became worthless. After the Japanese withdrawal, the British were not able to reassert control and allowed Burma to become independent. The fledgling government attempted to create financial stability by enacting a currency board and a number of protectionist policies. In 1962, the military took control, implementing backward economic policies that exploited the majority of the population. These policies continue to reward military cronies and marginalize average citizens to this day, Turnell stated.

15. In the 1980s, the junta nationalized all banks, demonetized the kyat to thwart speculators, and provided rural credit only through exclusive advance purchase of crops. Turnell noted the gap between the price the government paid and the actual market price for crops reached a high when the junta charged rice producers seven hundred percent on their product. It was around this time that the people began to riot and the junta crushed all demonstrations by killing thousands of protestors in 1988.

16. Following the protests, the junta allowed private banks to open and gave permission to foreign banks to operate in Burma (although none could operate effectively). With a lack of oversight, competition, and customers outside the government, Dr. Turnell stated that many Burmese banks turned to suspect business practices such as money laundering, fraud, ponzi schemes (a fraudulent investment operation that pays returns to separate investors from their own money or money paid by

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subsequent investors rather than from any actual profit earned) to earn a profit. This unsustainable banking system led to another crash in 2003 where the government exchange rate ranged between five and six kyat per USD, while the black market rate surpassed 1,200 kyat per USD. Today, both government and black market exchange rates hover around these respective ranges with the government rate being significantly undervalued.

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A Plethora of Problems  
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17. Dr. Turnell said the current Burmese economy is plagued by a number of afflictions including high inflation, total disregard for property rights, widespread distrust in the currency, high levels of corruption, numerous economic sanctions, and a general dearth of capital. Due to the total lack in consumer confidence and market stability, it is no wonder that there are no viable financial institutions or significant levels of FDI, he opined.

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Green Shoots in Microfinance?  
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¶8. Even though the Burmese financial sector is in shambles and essentially controlled by the military, Dr. Turnell reports that microfinance is a growing industry working to provide individuals the financing they need. Although there are a number of small institutions and informal micro lenders in Burma, PACT (Program for Accountability and Transparency) funded by UNDP, is by far the largest issuer of small loans. According to Turnell, PACT claims to reach approximately 300,000 Burmese borrowers, issuing loans based on the Grameen method where groups are formed to borrow and hold each member responsible for their portion of the loan. Lending is progressive, as a strong track record of repayment leads to larger loans.

¶9. Dr. Turnell stated that the average loan is approximately 32 USD, while the cost of writing the loan is 11 USD. For this reason, PACT charges an interest rate between thirty-eight and forty-five percent. Although this interest rate sounds high, Dr. Turnell said that people can receive exceptionally high returns from their loan.

¶10. While microfinance provides financing to some Burmese, Dr. Turnell opined that the future of microfinance in Burma is questionable. The military junta does not give micro lenders any legal status, restricts the areas in which they can operate, and is prone to expropriate money (Note: Embassy Rangoon notes this has not happened since 2004. End note.), provides a hostile macroeconomic climate, and does not help to capitalize the institutions looking to support the people. Operating micro lenders could be shut down or taken over at any time and absorbed into a state apparatus characterized by inefficiencies and corruption, he observed.

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Question and Answer  
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¶11. In response to audience questions, Dr. Turnell provided the following observations:

--Microfinance is not a strong stimulant to economic development. Capital is the most important input for sustained development.

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--Micro lenders tried to work with commercial banks, but the junta disallowed joint cooperation. (Note: Embassy Rangoon reports micro lenders are successfully operating in Burma without government intervention.)

--Micro lenders are faring well during the economic crisis. PACT reports high repayment rates as the poor rarely default on their debts as they will find a way to repay. Dr. Turnell reports 90 percent repayments (ten percent defaults).

--About ten percent of local borrowing and lending happens informally between acquaintances.

--seventy-five percent of remittances are used for survival purposes (food, shelter, clothing). Very little is used for income generation or business development.

--Remittance flows to Burma are down approximately 30 percent from 2008 due to the economic crisis (Ref A). Although there are no official numbers, many Burmese laborers in the tourism, construction, and garment industries are being laid off. Additionally, the fall in commodity prices negatively affects Burmese migrants as wages in the gas and agriculture sectors are falling.

--Dr. Turnell listed the methods used to send remittances to Burma: Forty-four percent of remittances are transferred by hundi, a system in which monetary value is transferred via a network of dealers or brokers from one location to another (Ref B). This transaction does not involve the transfer of currencies, rather, products and services are exchanged. Twenty-two percent of remittances enter Burma through carriers or merchants who actually bring cash over. Family members going to and from Burma with cash account for another twenty-two percent of remittances. Only six percent of remittances flowing into Burma arrive via formal methods through Burmese banks.

Four percent of remittances enter by a migrant hiring an accomplice to hustle cash into Burma. Two percent of remittances arrive by other methods.

--The vast majority of Chinese FDI in Burma is in the oil, gas, and mining sectors. There are a number of Chinese pawn shops, small time money lenders, and merchants operating in Burma. Aside from these industries, Burma receives very little FDI in sustainable growth industries.

--The economic sanctions did not stop Chinese investment in Burma.

--The economic sanctions are well-founded, as state agencies would become stronger without them.

¶12. This cable was coordinated with Embassy Rangoon.  
ANDERSON